



ROCHESTER

Minnesota



May 4, 2001

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To the Honorable Mayor, Members of the Common Council, and the Citizens of the City of Rochester:

We are pleased to submit this Comprehensive Annual Financial Report of the City of Rochester, Minnesota, for the fiscal year ended December 31, 2000. Responsibility for both accuracy of the data and the completeness and fairness of the presentation, including all disclosures, rests with the City. We believe the report is accurate in all material respects and is reported in a manner that presents fairly the financial position and results of operation of the various funds and account groups of the City. All disclosures necessary to enable the reader to gain the maximum understanding of the City's financial activities have been included.

The comprehensive annual financial report is presented in three sections:

1. The Introductory Section, which is unaudited, includes this transmittal letter, the government's organizational chart and a list of the City's principal officials.
2. The Financial Section includes the general purpose financial statements, the combining and individual fund and account group financial statements and schedules, and the independent auditor's report on the financial statements and schedules.
3. The Statistical Section, which is also unaudited, includes selected financial and demographic information, generally presented on a multi-year basis.

The organization, form and contents of this report were prepared in accordance with the standards prescribed by the Governmental Accounting Standards Board, the Government Finance Officers Association of the United States and Canada, the American Institute of Certified Public Accountants, the State Auditor's Office - State of Minnesota and the City Charter.

The City is required to undergo an annual single audit in conformity with the provisions of the Single Audit Act of 1984, the Single Audit Act Amendments of 1996, and U.S. Office of Management and Budget Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Information related to this single audit, including the schedule of expenditures of federal awards, findings and recommendations, and independent auditors' reports on the internal control structure and compliance with applicable laws and regulations, is included in a separate single audit report.

CITY OF ROCHESTER, MINNESOTA

REPORTING ENTITY AND ITS SERVICES

The financial reporting entity includes all funds and account groups of the City of Rochester. Rochester Public Utilities is a department of the City of Rochester and is therefore included in the Proprietary Funds section of this report. There are no legally separate entities that meet the requirements of being considered a component unit of the City.

The City provides a full range of services. These services include police and fire protection; construction and maintenance of highways, streets and infrastructure; electric, water, wastewater and downtown parking utilities, airport and transit services; recreational and cultural events.

The City of Rochester, incorporated on August 5, 1858, is governed under a charter adopted August 22, 1904. The Common Council is composed of seven Council members. Six Council members are elected by ward and the president is elected at large, all serving four-year terms. The government currently has a land area of 43 square miles and a population of 85,806. The government has the power by state statute to extend its corporate limits by annexation, which is done periodically when deemed appropriate by the governing council.

ECONOMY AND OUTLOOK

Rochester does not appear to be showing the signs of the weakening economy that is being reported at the national level. Continued strength in the health care sector and the stability of a major stalwart technology manufacturer are driving remarkable growth. Year 2000 census data report Rochester's population at 4.4% higher than last year's estimate and 21% higher than the 1990 census. Rochester is clearly on line to become the State's third largest city.

Located 78 miles southeast of Minneapolis and St. Paul, Rochester's strong economy is built around world-renowned health care, cutting-edge technology, agriculture and agribusiness. As home to the Mayo Clinic and IBM Rochester, the City has developed into an economic growth center and the cultural hub of southeastern Minnesota. Its many recreational and cultural activities draw people from southeastern Minnesota and northern Iowa. Add these benefits to a low crime rate and an exceptional school system and it is easy to see why *Money* magazine continues to rank Rochester in the top places to live.

Major Employers - Mayo Foundation. Mayo Foundation, the largest employer in Rochester, provides health care services for more than 400,000 patients each year. These patients come from all 50 states and more than 150 countries. Mayo provides comprehensive hospital and outpatient services at each of its three major locations -- Rochester, Minnesota; Jacksonville, Florida; and Scottsdale, Arizona. At each site, clinical practice is closely integrated with advanced education and research programs. Mayo Foundation also includes Mayo Health System, a network of clinics and hospitals in 60 communities in southern Minnesota, northern Iowa, and western Wisconsin.

In 2000, Mayo Foundation's total employment in all locations was 44,186 full-time equivalents, up from 41,265 or 7% over 1999. Employment at Mayo Medical Center Rochester, which includes Mayo Clinic, Saint Marys Hospital and Rochester Methodist Hospital, nearly paralleled that growth, reaching full-time equivalents of 24,587, up from 23,376 in 1999. Mayo-Rochester continued to be the largest revenue generator, responsible for 53 percent of Mayo's overall \$3.04 billion in 2000 patient revenue. Total patient revenue was up 11% from 1999. As a private, not-for-profit foundation, any excess of revenue over expenses remains with Mayo, helping fund the ongoing replacement and growth in working capital, research and education endowments, facilities and equipment.

CITY OF ROCHESTER, MINNESOTA

Mayo Medical Center continues its extensive construction program. The nine-story 194,900 square foot administrative services building and the utility plant facility were both completed in 2000. The eleven-story "Gonda" building program was revised soon after the start of construction with the decision to proceed immediately with the shell construction of an additional nine stories on the site due to continuing growth in demand for services. This nearly 1.4 million square foot clinical building will see a phased move-in beginning with the first floor late in 2001. Major remodeling of the Mayo Clinic Building will begin to occur as soon as this move occurs. Additionally, Mayo Clinic Rochester recently broke ground on an additional parking ramp to serve both its growing patient and employee needs. Altogether, Mayo Foundation occupies approximately 11 million square feet in Rochester, or about 2.5 times the size of the Mall of America in Bloomington, MN.

Major Employers - IBM Rochester. IBM's facility in Rochester, Minn., plays a strategic role in the company's e-business strategy. Its predominant mission is the development, manufacture and support of IBM eServer and storage products. The Rochester laboratory is also involved in cross-platform software development for other IBM products. IBM inventors in Rochester have earned more than 1,800 U.S. patents over the years for product innovation, helping the Rochester plant to remain one of the corporations most profitable operations.

IBM's total corporate earnings for the 1st quarter of 2001 grew by 18% to \$1.75 billion, driven largely by sales from its servers and its Global Services business. Sales of IBM's pSeries servers (formerly RS/6000) produced in the Rochester facility, led that growth rising 33 percent from a year earlier. Referring to weakening economic conditions during the quarter, IBM chairman, Louis Gerstner stated, "times like these play to our strengths as a diversified, services-led company."

Servers produced in Rochester are shipped worldwide, including to North and South America, Pacific Rim countries (e.g., Japan and China) and Australia. The Storage Technology Division laboratory, working in cooperation with IBM laboratories at other locations, focuses on the development of small-format, high-capacity hard disk drives. STD's substrate manufacturing facility in Rochester is IBM's worldwide center of competency for glass disk substrates used in its hard disk drives.

In 2000, IBM was awarded the National Medal of Technology -- which recognizes lasting contributions to America's competitiveness and standard of living -- for the company's leadership in developing and commercializing data storage technology.

Some 30 IBM organizations are represented by the approximately 5,300 regular employees working at IBM Rochester. Employment numbers dropped by about 500 during 2000 as IBM sold its electronic card assembly division to Celestica, Inc. who hired those employees to work in their recently-completed manufacturing facility here in Rochester.

IBM occupies about 3.6 million square feet of owned and leased space in Rochester (equivalent to about 78 football fields). It is the largest IBM facility in the world under one contiguous roof. IBM remains Rochester's second-largest employer and a significant force in Rochester's thriving economy.

Other Employers. Although Mayo and IBM are the major employers in the City, thirty-eight manufacturing and service firms in the community report 100 or more employees at the end of 2000. The restructuring of IBM in the early 1990's provided the impetus for numerous start-ups and expansions that continue to add to that employment diversity.

CITY OF ROCHESTER, MINNESOTA

PEMSTAR, an engineering and contract manufacturing company founded by former IBM executives in January of 1994, has continued to enjoy stunning growth. The company offers a broad range of services across five industries including Communications, Computers and Peripherals, Medical, Storage and Industrial Equipment. PEMSTAR opened with a single leased factory and design center in Rochester seven short years ago, but has now grown to have over a million square feet in 15 facilities at 13 strategic locations in the United States, Mexico, Asia, Europe and South America. In the last five months alone, the company has expanded -- with a manufacturing site in Brazil, an engineering site in Japan and a major manufacturing plant in the Boston area. Such expansions earned PEMSTAR a place on Inc. Magazine's list of "fastest-growing companies in the country" in October of 2000. The Inc. 500 is an exclusive report on the companies and CEOs who are changing the face of American business. Noteworthy alumni include Microsoft, Timberland, Dominos Pizza and Patagonia.

PEMSTAR has now grown to around 680 workers in their three Rochester facilities and nearly 3,000 worldwide. For its year ending March 31, 2001, net sales totaled \$635.3 million, a 61 percent increase from the previous year. Net income was \$6.7 million, versus \$2.7 million for the prior fiscal year, or a 148% increase.

In August of 2000, the company made its first public stock offering that was used to pay down outstanding debt and build additional businesses. Announcement has just been made for an additional public offering of 5.1 million shares to occur within a month, pending regulatory approval. PEMSTAR is also in discussions with the City of Rochester for a 100,000 square foot expansion onto one of their manufacturing facilities in Rochester that is planned to occur during 2001.

Celestica Inc., the world's third-largest contract manufacturer of electronics with over 19,000 employees worldwide, completed its purchase of the Electronic Card Assembly and Test plant from IBM in March of 2000. As part of the deal, the Canadian-based company hired over 500 regular IBM employees. The company later started construction on a 200,000 square foot manufacturing facility in Rochester. The facility opened in April, 2001 where the company presently employs over 700 people at this facility.

Federal Express and Airborne Express continue to expand air cargo operations at Rochester International Airport since their first daily flights in 1996. Following Federal Express' construction of a 90,000 square foot on-field distribution facility in 1999, Airborne Express just completed their own 15,000 square foot facility in 2000 and now employs 27 employees at this facility. Air Cargo shipments were up 16.9 percent over a year ago and 0.5 percent over first quarter 2000, marking over five years of continuous and substantial growth. Not only does the airport gain from land leases and fees on pounds of cargo, but these services also make the local businesses more competitive in the marketplace by improving their shipping and receiving efficiencies. This activity is beginning to spur additional development in the airport area including a new hotel and restaurant that are soon to break ground.

Housing Development. The recent surge in job creation caused by expansions of Mayo, PEMSTAR, Celestica, the hotel industry, and others, began creating significant pressure on employees' ability to find affordable housing in the Rochester Area. Community leaders joined with the City to establish the "First Homes" program, a private, non-profit project administered by the Rochester Area Foundation (RAF). In addition to the City's involvement with the program, the RAF has raised \$11.1 million (\$5 million of which came from the Mayo Clinic), and are well within reach of their \$12.75 million goal. The total program is expected to finance construction of 500 single-family homes and 375 rental units by 2004. To date, 317 single-family homes and 160 rental townhouses have been approved. The program was recently praised in "Leading the Field," a national

CITY OF ROCHESTER, MINNESOTA

publication of Funders Network for Smart Growth and Livable Communities. The publication noted the project is characterized by both “regionalism and collaboration” where “major sectors of the community have come to understand that the provision of housing for all members of society is a prerequisite to regional economic success.”

Downtown Development. The City's leadership recognized the importance of an economically healthy downtown to the general well being of the community and to the growth and expansion of our largest employer, Mayo Foundation. The Downtown Development District was established in 1976 to provide a financing tool to encourage reinvestment in the City's central business district. That district was legally closed to new projects at the end of 2000 with all remaining collections being dedicated to debt service repayment. From 1976 through 2000, the City has implemented or assisted in 44 redevelopment projects costing \$47.9 million. These investments have all contributed to the vibrant downtown Rochester residents and its estimated 1.5 million visitors enjoy each day. As this district drew to a close, the City was in talks with a developer to establish a new district that would assist in a 24-story extended-stay hotel and retail/office complex in the downtown core.

Building Permits. The first year of the new century again set records for building permit activity with the valuation of building permits issued at \$430 million. Total numbers of permits increased from 3,060 in 1999 to 3,308 in 2000 for another new record. The average yearly valuation of all building permits issued in the past decade has been \$213 million, which includes \$57.4 million as the average yearly valuation for new homes constructed. The average permit valuation for a new home constructed in Rochester during 2000 was \$135,000.

Permits for public buildings were led by the new University Center Rochester Recreation and Sports Facility at \$13 million and an addition to the Rochester Civic Center at \$11 million. Additions and remodeling of the school district's Community Services Building came in at \$4.5 million. Mayo Foundation projects accounted for almost one-third of the total work, including for the new Gonda Building at \$102 million, downtown campus buildings at \$24.4 million (which includes a new utility plant for \$3.8 million and Stabile Building fit-up for \$5.4 million), and St. Mary's campus buildings at \$6.7 million. Total permits issued to IBM Corporation were \$17 million.

Construction continued at two new shopping centers: Broadway Commons and Rochester Marketplace with permits for Super Target at \$7.1 million and Home Depot at \$4.4 million. Wal-Mart's additions and remodeling at another center totaled \$6.6 million. \$2.3 million in permits were issued for the Celestica office/manufacturing site. Of all permits issued for multiple-unit buildings, four 75-unit apartment buildings alone were for \$24.5 million

During 2000, 675 permits for single-family dwellings were issued at a total valuation of \$91 million. With another 959 multiple units constructed and 68 manufactured homes set up, 1,702 total dwelling units were added last year. Total housing units (including single and multiple dwelling units) for the last 5 years is 5,148, with 61% of the units in the northwest quadrant of the city, 21% southwest, 9% northeast and 9% southeast.

Building permit activity in the first five months of 2001 continues the record-setting pace of the past few years with 366 single-family dwelling permits and 1,372 total building permits issued. Total valuation for this period is \$125 million, an 18% increase over the same period last year.

Summary. Rochester's economic growth continues to surge. Total employment has grown at a healthy 4.3 percent rate during the past twelve months ending March 31, 2001 for a gain of 3,499 jobs. The March 2001 unemployment rate was 2.4 percent for the Rochester metropolitan area,

CITY OF ROCHESTER, MINNESOTA

down from 2.5 percent a year ago and below the state and U.S. averages of 3.2 and 4.2 percent respectively.

The local economy has a tradition of being insulated from economic downturns. The Mayo Clinic and IBM are the foundation for Rochester's economy. Significant diversity exists, however, in Rochester's other service and goods producing employers. They all have helped provide the stability that has enabled the city to maintain our AAA bond rating for more than 20 years. Clearly, Rochester continues to have an enviable economic outlook.

MAJOR INITIATIVES

For the Year. The 2000 budget program identified and provided for several major programs needed to meet citizens' needs for services and to safeguard the environment in conformity with applicable federal and state standards. These programs included municipal building construction, construction of additional trunk line sanitary sewer and water mains to serve new subdivisions, street construction and reconstruction, affordable housing, and the continuation of the five major projects approved under the local option sales tax that was continued by referendum.

During the Year. The joint City and County Law Enforcement Center completed purchase, installation and training of a new emergency dispatch and records system. Including redundant hardware systems, the two governments invested over \$2.0 million in this project to improve efficiencies and reliability in this important government service.

In 2000, the City continued its involvement in affordable housing by participating in the "First Homes" program noted above. The City is participating in this program by providing tax increment financing, housing tax credits, and revenue bonds. In 2000, the City provided up front TIF assistance to 125 single family dwellings in the City in the amount of \$1.25 million. In addition, the City issued housing tax credits in 2000 in the amount of \$135,000 on a 100-unit affordable rental townhome project (Georgetown Townhomes). In 2000, the City also issued \$7.5 million in housing revenue bonds to assist in the financing and construction of a 100-unit affordable rental townhome project (Weatherstone Townhomes).

City and community leaders completed work on the Soldiers Field Veterans Memorial in June of 2000. Hundreds of names have been inscribed on a granite wall or in granite plaques on the ground. Scenes depicting various wars where our servicemen gave their lives are engraved on the granite panels around the outside of the memorial. Final detailed engravings are being completed this spring. The project is expected to cost nearly \$5 million with most of this funding coming from donations and the sale of memorial engraved "paver" bricks. Chosen for the cover photo for this report, the memorial has already received rave reviews from thousands of veterans and their families.

The Fuad Mansour Soccer Complex was completed including seven regulation soccer fields built on the Rochester Community and Technical College Campus. The joint project was developed with donations of land from the college, cash donations from the soccer community, and funding from the City's park and recreation department. These soccer fields are the beginning of additional sports facilities soon to be completed as noted below.

Work also began in earnest on the five major projects approved for local option sales tax funding. A total of \$71.5 million was authorized for a water quality protection program, higher education facilities, airport improvements, a civic center expansion, and road improvements,.

CITY OF ROCHESTER, MINNESOTA

- Water Quality. Approximately \$22.5 million of sales tax funds will help extend water, sewer, and stormwater lines and increase existing trunk line capacity. Over 2,000 homes surrounding the City are using septic systems that were built prior to adoption of standards for well and septic system construction. Funds will provide an affordable solution for property-owners to remedy their systems, a reduction in groundwater pollution, and protection for the City water supply. To date, the City has authorized and awarded bids on over \$17 million in trunkmain construction projects to serve eligible properties. A total of 1,029 properties will be served by those projects already underway with another 1,000 or so yet to be served. This significant project will span multiple years and have a total estimated cost of over \$60 million. Annexation of affected property will occur and significant in-fill development areas will become available as a result.
- University Center Rochester (UCR). Approximately \$20 million in sales tax funding will improve education facilities at the University Center Rochester. The first \$10.4 million is already being spent from an escrow account to match \$5 million in State funds for a Regional Sports and Recreation complex at UCR. This 114,670 square foot state-of-the-art facility is scheduled for completion by the end of this year. It is located on the University campus, but will be under an agreement with the City to be used by the community when not in use by the college. The facility is located adjacent to both the soccer complex noted above and the land on which additional baseball diamonds, football practice fields, and football/soccer stadium are all under construction. This 100-acre sports complex to be shared by the college and the whole community will become one of the biggest sports complexes in the Upper Midwest.
- Civic Center Complex. Sales tax funding of approximately \$13.5 million, matched by \$2.8 million in State funding, is being used to construct a new 25,000 square foot exhibit hall and a 10,000 square foot lobby expansion on the City's civic center. These improvements will keep the center competitive with other civic centers for convention and meeting business. The hotel and restaurant industry employs 8,000 people and is the third largest industry in SE Minnesota. Over 5,000 hotel rooms exist in Rochester with additional hotel facilities currently breaking ground. The Civic Center improvements will attract business to support this industry while avoiding a property tax increase. Included in the project is an expansion and renovation to the Civic Theatre located on the site and now connected to the main facility and skyway system. The project is on schedule for a September 11th grand opening celebration.
- Rochester International Airport. Approximately \$5.5 million in sales tax funding is being used to match other Federal and State funding to extend primary and secondary runways and remodel the terminal building and parking lot. These improvements will benefit passenger, air carrier and air cargo operations, which are essential to the local economy. Dedication of the \$3.5 million relief runway extension and the \$3.7 million terminal and parking lot renovation was held in October of 2000. The extension of the primary runway will begin the design phase in another year.
- Transportation Improvements - U.S. Highway 52. This \$100 million State project will require a City cost of \$10 million for frontage roads, utility relocations, and reconstruction of local streets. U.S. Highway 52 in Rochester is a regional traffic artery, which has more traffic than any other road in SE Minnesota. Sales tax funding will accelerate the construction schedule and will avoid a City property tax increase for this regional project. Right-of-way purchase and clearing continued on this project throughout the year. A four-year construction schedule was adopted by the council beginning in 2002.

At the close of 2000, Rochester Public Utilities authorized contracts to begin construction of a new gas turbine peak-power electric generation plant. The final design was accepted during the year with construction getting underway in the first months of 2001. Final installation is expected in the first half of 2002. The generator is needed to protect the utility from the extreme prices demanded for purchased power during peak demand times. Coupled with transmission system improvements

CITY OF ROCHESTER, MINNESOTA

and renovation of the utility's existing turbine, a utility revenue bond of \$37.2 million was sold in December of 2000 to fund these important projects.

For the Future. Most of the sales tax projects, as well as the housing initiatives noted above, are multi-year projects. The staff and construction crews will be busy in 2001 and beyond bringing the projects to completion.

The City will also be implementing a new enterprise software system purchased at the end of 2000 to replace legacy financial and human resources data systems. The planned "go-live" date for the system is January 1, 2002. These systems will be used to improve both the efficiency of operations and the access to real-time data for our managers. It will also assist in the implementation of new reporting requirements under GASB 34.

A three-story \$8.2 million dollar Rochester Art Center is planned to be constructed adjacent to our civic center and funded by both the City and through fundraising of the local non-profit agency that would run the center.

The City will be working to meet the infrastructure and daily service needs of one of the fastest growing communities in the state. Budgeted capital improvements for 2001 to meet those needs are over \$44 million.

FINANCIAL INFORMATION

All financial transactions of the City are accounted for in specific funds authorized or required by the City Charter, Chapter XI. The City's accounting records are maintained on the accrual, or modified accrual basis, as appropriate. The proprietary fund types use the accrual basis of accounting. The governmental and fiduciary fund types utilize the modified accrual basis of accounting. The notes to the financial statements (Note 1) present a summary of the significant accounting policies.

Single Audit. As a recipient of federal, state and county financial assistance, the City also is responsible for making sure that an adequate internal control structure is in place to ensure compliance with applicable laws and regulations related to those programs. This internal control structure is subject to periodic evaluation by management and the internal audit staff of the City.

As a part of the City's single audit, described earlier, tests are made to determine the adequacy of the internal control structure, including that portion related to federal financial assistance programs, as well as to determine that the government has complied with applicable laws and regulations. The single audit for the fiscal year ended December 31, 2000 has not yet been completed but we do not anticipate any instances of material weaknesses in the internal control structure or significant violations of applicable laws and regulations.

Budgetary Control. The City maintains management budgeting controls at the subfunction level by an encumbrance system. At the function level, only the Common Council can legally revise the adopted budget. A contingency appropriation is provided for this purpose. Generally, budget amendments will not alter the total expenditure budget of the City. All 2000 amendments, individual and total, were not material in relation to the original appropriation. Expenditure appropriations lapse at year-end. The expenditure budget may not legally be exceeded at the function level of control presented in Form A-3 in the Financial Section of this report. Monitoring of budgets is maintained at the department level by departments or divisions. However, expenditures in excess of the departmental budget require administrative approval. Open encumbrances are reported as reservations of fund balance at year-end.

CITY OF ROCHESTER, MINNESOTA

General Governmental Functions and Fund Balance (Forms BCDEF). A summary of general governmental revenue sources in the General and Special Revenue Funds for the years ended December 31, 2000 and 1999 is presented in the following table:

GENERAL GOVERNMENTAL REVENUES

Revenue Sources	2000		1999		Increase (Decrease) from 1999	
	Amount	% of Total	Amount	% of Total	Amount	%
General Property Taxes	\$ 11,968,585	22%	\$ 14,691,534	30%	\$ (2,722,949)	-19%
Lodging & Franchise Taxes	3,333,724	6%	2,220,108	4%	1,113,616	50%
Licenses and permits	2,805,189	5%	2,588,584	5%	216,605	8%
Fines and forfeits	444,225	1%	423,285	1%	20,940	5%
Intergovernmental revenues	14,975,186	27%	14,710,492	30%	264,694	2%
Charges for services	7,950,457	15%	7,485,728	15%	464,729	6%
In lieu of taxes	7,247,020	13%	6,633,974	13%	613,046	9%
Other revenue	5,994,203	11%	836,807	2%	5,157,396	616%
Total	\$ 54,718,589	100%	\$ 49,590,512	100%	\$ 5,128,077	10%

Total general government revenues increased 10% over 1999. Franchise fees increased significantly from the prior year as the City entered into a new agreement with the local cable provider. Fees were increased from 3% to 5% of revenue and was applied to additional services such as the cable internet option. Building permit and inspection fees set another new record in 2000, up \$216,605 or 8% over last year's record. Charges for services category showed sizeable gains over last year with most of the \$464,729 gain due to increased program fees at the Mayo Civic Center and our golf learning center and three golf courses. The airport operations also saw a sizable gain in fee income, up \$125,186 from the prior year.

In-lieu of taxes also increased significantly over last year as the community continued to grow. Increased electric and water consumption increased in-lieu of tax payments by \$479,632 while sewer utility in-lieu payments increased \$110,000 as we continue to step up to our stated policy goal of 7% of fee collections.

Other revenue increased substantially as the City received a nearly \$4.1 million refund from the closeout of the police and fire pension funds. This program was merged with the PERA police and fire fund during 1999 and the City was able to recover the amount in excess of full funding of the actuarial liability of the plan. These monies were used to fund police and fire current expenditures during 2000 and allowed the City to reallocate tax levy funding to the capital improvement program for this one year. That reallocation is reflected above in the reduction in the general property taxes category, showing a \$2.7 million reduction from the prior year.

CITY OF ROCHESTER, MINNESOTA

General governmental expenditures. The following table presents a comparative analysis of the major general governmental expenditures in the General and Special Revenue funds by function:

GENERAL GOVERNMENTAL EXPENDITURES

Function	2000		1999		Increase (Decrease) from 1999	
	Amount	% of Total	Amount	% of Total	Amount	%
General Government	\$ 4,291,500	9%	\$ 4,013,736	9%	\$ 277,764	7%
Public Safety	20,479,801	41%	19,469,713	42%	1,010,088	5%
Public Works/Airport	11,464,730	23%	10,065,589	22%	1,399,141	14%
Library	3,946,256	8%	3,806,174	8%	140,082	4%
Culture	566,243	1%	503,500	1%	62,743	12%
Parks and Recreation	8,270,906	16%	7,678,182	16%	592,724	8%
Economic Development/ Tourism	823,529	2%	786,822	2%	36,707	5%
Community Reinvest./ Unallocated	327,287	0%	217,714	0%	109,573	50%
Total	\$ 50,170,252	100%	\$ 46,541,430	100%	\$ 3,628,822	8%

Total expenditures in these funds increased 8% over the prior year. The increase in the general government category beyond that of regular salary increases was due to new employee expenses in the information systems, attorney, and human resources divisions as well as higher contract attorney costs. Public safety cost increases were primarily held to annual salary adjustments with the exception of additional employee expense in the building safety department necessary to meet service demands in that area. Public works saw increases in its mass transit program costs of \$445,825 due to increased routes and higher street and alley costs of \$728,020 as they stepped up their maintenance efforts on our ever-growing street system. Park and recreation increases showed up mainly in the golf division as the new learning center got into full swing, and in the civic center as more and more events took place at this facility.

Fund Balance. The unreserved fund balance in the general fund as of December 31, 2000, was \$16,734,379 an increase of \$1.86 million from the prior year and amounting to 46% of 2000 general fund expenditures. This balance will provide for a gradual service level adjustment should reductions in local government aid or other unforeseen events occur. It also provides adequate cash reserves to assure the City can continue the long-standing policy of providing cash flow for general fund operations with these reserves until general property tax and local government aid revenues are received. As of December 31, 2000, portions of this balance were designated as general contingency for future compensated absences in the amount of \$3,969,828 and for subsequent years' appropriations totaling \$2,246,065.

Because of charter provisions for separate administering boards, the library and municipal recreation system departments maintain their own unreserved fund balances in the Special Revenue Funds. Unreserved fund balance for the library fund amounted to \$1,188,777 at the end of 2000, or 30.1% of expenditures. The municipal recreation system unreserved fund balance was \$2,108,411 or 25.5% of expenditures.

CITY OF ROCHESTER, MINNESOTA

Debt Administration. Total long term debt outstanding at year-end 2000 and 1999 is as follows:

Debt Issue Type	Balance 12/31/00	Balance 12/31/99
G.O. Tax Increment	\$ 8,419,380	\$ 10,606,025
G.O. Sales Tax	27,625,000	0
G.O. Wastewater	8,875,000	9,450,000
Electric Utility Revenue Bonds	37,290,000	0
Notes Payable	893,243	1,129,248
Total	\$ 83,102,623	\$ 21,185,273

Temporary sales tax bonds were issued to meet the initial cash flow needs of the five sales tax projects. Total authorized bonding for these projects is \$71.5 million, however sales tax revenue flows may allow bonding to be kept to a minimum. Cash flows will be reevaluated at the end of the three-year term of these temporary bonds and term bonds will likely be issued to retire the remaining debt.

The City's electric utility issued \$37.29 million in revenue bonds to fund a gas turbine peak power plant and major system improvements as noted above.

The City applied available funds from the Downtown TIF District to fully retire the \$1,286,645 previously outstanding on the 1997 tax increment bond during 2000.

All other debt was retired according to their respective repayment schedules. The reader should refer to the notes to the financial statements (Note 7) for a summary of the City's bond transactions for the year.

Bond Rating. In 1977, the City's general obligation double A credit rating was revised to a triple A by both Moody's and Standard and Poor's. The City has consistently maintained those ratings for the last 29 years. Bonds rated triple A are considered to be of the best quality and therefore incur the lowest interest costs when borrowing. Both Moody's and Standard and Poor's completed a rating review of the City's debt obligations during 2000. The City's electric utility had its newly-issued revenue bonds rated by Moody's and Fitch. The City's current bond ratings for both general obligation and utility revenue bonds outstanding are as follows:

	Moody's Investors Service	Standard & Poors	Fitch Investors Service
General Obligation Bonds	Aaa	AAA	
Electric Utility Revenue Bonds	Aa3		A+

Capital Project Funds (Form H). The Capital Projects Funds are established to receive all taxes levied, and such other monies directed by the Common Council including proceeds from the issuance of general improvement bonds, and to use these monies for the acquisition of lands, improvement and construction of buildings, bridges, and other permanent improvements. The capital projects approved in the six-year Capital Improvement Program are accounted for in these funds. It has been Common Council policy to allocate general property taxes and operating

CITY OF ROCHESTER, MINNESOTA

transfers for capital improvements and debt service requirements, thereby avoiding a "roller-coaster" effect on the tax levy and saving interest cost on bonded debt.

Improvement construction includes sewer and water construction, streets and street improvement, curb and gutter, sidewalks, and storm sewer projects. Improvement construction is reported in the Capital Project Funds in accordance with Statement No. 6 of the Governmental Accounting Standards Board.

Capital Project expenditures and other financing uses during 2000 totaled \$49,405,712, up from \$30,740,200 in 1999 as expenditures on the sales tax projects noted above got underway. A breakdown of those expenditures by category as well as funding sources can be found in Form H-2 of the financial statements.

The six-year Capital Improvement Program is reviewed annually and revised, as necessary. The annual review assures that the program will be a continuing part of the planning process and that it will be consistent with changing demands as well as changing patterns of cost and financial resources.

Enterprise Funds (Form I). The City's enterprise funds were established to account for activities of government units that are self-supported through user-charges. The City operates the following enterprise operations: parking utility, municipal electric and water utility, and the sewer utility. The electric and water services, comprising the Rochester Public Utilities (RPU), are under the direction of the Board of Public Utilities. Governmental accounting principles require these operations to be included in the annual comprehensive report of financial operations of the various City functions established by City Charter. A separate annual financial report has also been issued for these enterprise funds.

The parking, electric, water and sewer utilities all make in lieu of tax payments to the City's general fund. Electric and water in lieu of tax payments are determined on a percent of unit sales while the parking utility's payments are based on 9% of gross revenue. The sewer utility initiated in lieu of tax payments in 1998 and is scheduled to ramp up to 7% of revenues. In 2000, in lieu of tax payments for the parking, electric, water and sewer utilities were \$242,551, \$6,310,394, \$309,934 and \$370,000 respectively.

Operating results for all City enterprise funds during 2000 are summarized as follows:

	<u>Parking Utility</u>	<u>Electric Utility</u>	<u>Water Utility</u>	<u>Sewer Utility</u>
Operating revenue	\$ 3,140,849	\$ 88,299,896	\$ 5,028,596	\$ 8,625,070
Less: Operating expenses	<u>2,005,385</u>	<u>83,825,595</u>	<u>3,421,651</u>	<u>5,025,474</u>
Operating income before depreciation	1,135,464	4,474,301	1,606,945	3,599,596
Less: Depreciation	<u>749,934</u>	<u>3,524,748</u>	<u>428,954</u>	<u>2,839,526</u>
Operating Income	\$ 385,530	\$ 949,553	\$ 1,177,991	\$ 760,070

Parking Utility revenues were up nearly 5% in 2000 as all ramps saw increased activity. The fund reported operating income of \$385,530, which was off \$42,081 from the prior year, however, as maintenance efforts on the ramps were stepped up.

CITY OF ROCHESTER, MINNESOTA

The Electric Utility realized its second consecutive year of growth in operating income, up 73% or \$402,149 from the prior year. Rates were increased 4.5% in February of 2000 to meet planned capital needs, but the continued increasing demand from a growing community also drove increased sales. No rate increases are planned for 2001 as the utility is committed to providing the lowest possible cost to its customers while continuing to provide sufficient capital to meet growth demands of the community.

The Water Utility also realized an increase in operating income for the year. Total sales were up 7.9% after a 10% rate increase for the year. The rate increase was necessary to maintain an adequate cash reserve while funding increased utility expenditures. Operating income in 2000 of \$1,177,991 was up from \$473,946 the year earlier.

The Sewer Utility continued its third in a series of five approved rate increases averaging 2.5%. These increases were the result of a 1997 rate study and planned system improvements. Unit sales decreased, however, especially in the industrial sector as a major manufacturer switched one of its line processes and required less water during the year. With total sales down nearly \$300,000 for the year and the increased in-lieu of tax payment, operating income was off nearly \$460,000 for the year.

Internal Service Funds (Form J). The Equipment Revolving Fund was created by Council resolution for the purchase and replacement of rolling stock equipment. City departments pay rental charges to the fund for equipment used in providing services. The Common Council approves replacements during the annual budget review. Retained earnings in the fund are available for equipment replacement.

During 1998, the City also established an Information Technology Revolving Fund. Operating much like the equipment revolving fund, departments pay rental charges for computers and other office technological equipment. Reserve cash balances in the fund are used to discount the rental charges thereby reducing and leveling out the taxpayer's cost of providing employees with this needed equipment.

Risk Management. The City's risk management activities are also accounted for in the Internal Service Funds at the Self-Insurance individual fund level. Premiums are paid into the self-insurance fund by all other user departments (funds), and are available to fund claims, claim reserves and administrative costs of the program. Interfund premiums are based principally on claims experience and are reported as quasi-external interfund transactions.

The City maintains a self-insurance program for employee group health coverage and workers' compensation and a high deductible policy on property and casualty coverage. The group health program is limited to losses of \$225,000 per claim with a variable annual aggregate, and the 2000 workers' compensation exposure is limited to \$620,000 per occurrence, both through the use of stop-loss policies. The City's general and auto liability policies retain a \$100,000 aggregate deductible exposure with a \$1,000,000 statutory limit of coverage. The City recognizes a liability on individual claims when a claim is probable and the amount can be reasonably estimated. In addition the City recognizes an estimated liability on claims that have been incurred but not reported. An indication of the effectiveness of the workers' compensation program is that the premium allocation for workers' compensation for 2000 is estimated to be a factor of 0.10 of the Workers' Compensation Reinsurance Association adjusted pure premium exposure base rate. Health coverage premiums were increased 4% in January of 1999 and 15% for 2000 in response to increased loss experience in this area. Premiums still remain below average market for comparable coverage.

CITY OF ROCHESTER, MINNESOTA

Employee Retirement Systems. Substantially all employees of the City of Rochester are covered by a statewide defined benefit pension plan administered by the Public Employees Retirement Association of Minnesota (PERA). Employees participated in one of the following plans during 2000:

Public Employees Retirement Fund (PERF), a cost-sharing multiple-employer plan
Public Employees Police and Fire Fund (PEPFF), a cost-sharing multiple-employer plan

PERF members belong to either the Coordinated Plan or the Basic Plan. Coordinated members are covered by Social Security and Basic members are not. All new members must participate in the Coordinated Plan. All police officers, fire fighters and peace officers qualifying for membership by statute are covered by the PEPFF. All pension disclosures are presented in Note 12 to the Financial Statements.

Cash Management. Cash temporarily idle during the year was invested in U.S. Treasuries, U.S. Government Agencies, commercial paper, AAA-rated municipal bond and a daily money market mutual fund. The amount of interest earned in 2000 was \$7,877,689 compared with \$6,124,161 in 1999, which resulted in a yield of 6.11% in 2000 compared with a yield of 5.62% in 1999. To provide maximum return, substantially all investments are pooled on an interim basis within an Investment Trust Clearing Fund.

The City's investment policy provides that all investment decisions shall be prudent, following safety and liquidity guidelines to minimize credit and market risks. As disclosed in Note 3, all deposits were either insured by federal depository insurance or collateralized. The City does not use leveraging strategies to enhance yield nor does it invest in derivative products for speculative profit. All collateral on deposit was held either by the City, its agent, a financial institution's trust department, or the Federal Reserve Bank held in the City's name. The classification of the category of credit risk is covered in Note 3 to the financial statements.

OTHER INFORMATION

Independent Audit. State law provides that the City may arrange for examination of its books, records, accounts and affairs, or any part thereof, by the State Auditor, or by a Certified Public Accountant. It has been a long-standing policy of the City to provide for a complete annual audit of City records by a Certified Public Accountant. The independent auditors' report has been included.

Awards. The Government Finance Officers Association (GFOA) awarded a Certificate of Achievement for Excellence in Financial Reporting to the City of Rochester, Minnesota for its comprehensive annual financial report for the fiscal year ended December 31, 1999. The Certificate of Achievement is a prestigious national award recognizing conformance with the highest standards for preparation of state and local government financial reports.

In order to be awarded a Certificate of Achievement, a government must publish an easily readable and efficiently organized comprehensive annual financial report, whose contents conform to program standards. The CAFR must satisfy both generally accepted accounting principles and applicable legal requirements.

A Certificate of Achievement is valid for a period of one year only. The City of Rochester has received a Certificate of Achievement award each year for the last 32 consecutive years (1968 – 1999). We believe our current report continues to conform to the Certificate of Achievement

CITY OF ROCHESTER, MINNESOTA

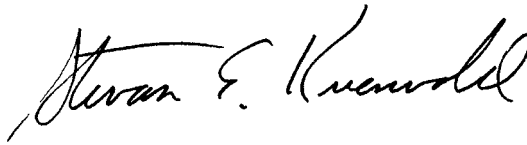
program requirements, and we are submitting it to GFOA to determine its eligibility for another certificate.

Acknowledgments. The preparation of this report could not be accomplished without the professional, efficient services of many dedicated people. We first express our appreciation to all members of the Finance department who assisted and contributed in preparing the report. We also thank the staff of Smith, Schafer and Associates, Ltd. for their assistance and review of the document. And finally, we acknowledge the Mayor and the members of the Common Council for their interest and support in planning and conducting the financial operations of the City in a responsible and progressive manner.

Respectfully submitted,



Dale R. Martinson
Director of Finance



Stevan E. Kvenvold
City Administrator